Volume Title: Trade and Employment in Developing Countries, 3: Synthesis and Conclusions

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Volume Publisher: University of Chicago Press

Volume ISBN: 0-226-45495-9

Volume URL: http://www.nber.org/books/krue83-1

Publication Date: 1983

Chapter Title: Conclusions

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Chapter URL: http://www.nber.org/chapters/c8769

Chapter pages in book: (p. 185 - 188)

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At the outset of the project the intent was to ascertain the extent to which domestic factor market conditions impinged on the realization of labor-abundant developing countries' comparative advantage in international trade. It was assumed that the appropriate trade data could be assembled and that existing analyses of developing countries' factor markets could be relied upon as an input in analyzing the links between trade strategies and employment.

Perhaps the most striking findings emerging from the trade strategies and employment project were that, on one hand, despite factor market conditions, developing countries' manufactured exports tend to exhibit the factor intensity consistent with their endowment, and that, on the other hand, the scope for further increasing their demand for labor through both trade policies and realignment of domestic factor market incentives is sizable.

Thus, in answer to the questions initially raised, there does not appear to be any conflict between objectives associated with more rational resource allocation and increasing the demand for labor, especially unskilled labor. Indeed, the degree to which the project countries' exportables were intensive in the use of unskilled labor was one of the important findings to emerge from the country studies.

An equally striking finding was the extent to which our knowledge and understanding of factor markets in developing countries is imperfect. Analysis of the interaction between trade strategies and domestic factor markets was generally more constrained by a lack of data and analyses on domestic factor market conditions than by lack of data and analyses on trade strategies.

The project has raised as many questions as it has answered, but answering most of them will require intensive examination and understanding of the functioning of domestic factor markets. The evidence is striking on the size of the divergence in capital/labor costs between sectors of the economy in which labor legislation is enforced and access to credit and import licenses is fairly free and those sectors hiring without constraints and unable to secure favored treatment in obtaining loans or capital goods. Although the estimates in chapter 8 provide some basis for assessing the effects of such differences, a great deal of work remains to be done in understanding factor market interventions and their effects. The orders of magnitude are surely large enough that it is at least plausible that low observed elasticities of employment with respect to output may be explicable in terms of factor market interventions. Regardless of whether those distortions are partly or almost entirely to blame for the failure of employment opportunities to grow, finding ways to remove incentives for using capital-intensive techniques is one component of any effort to increase real incomes and employment opportunities.

Despite data limitations and imperfect understanding of factor markets, the evidence from the country studies and from the project as a whole strongly suggests that there are gains to be had in resource allocation and employment from shifting to an outer-oriented trade strategy. Moreover, the extent of the potential gain very much depends on the degree to which factor markets function appropriately. While alteration of the trade strategy itself may remove one source of distortion in costs of using capital-intensive techniques, it is clear that credit rationing, tax structures, and labor legislation also play important roles.

In many of the project countries, appropriate factor market incentives to producers could have significantly increased the demand for unskilled labor under the existing trade strategy. Likewise, an altered trade strategy could have brought sizable increases in the demand for unskilled labor even in the presence of inappropriate relative prices for factors of production. Obviously, however, the greatest potential for employment gain is in those situations where the shift in policy realigns incentives in both the domestic factor market and the trade regime. The extent to which there may have been interaction between inner-oriented trade strategies and factor market distortions, both leading to high capital/output ratios and low rates of increase in the demand for labor, is striking.

Moreover, the income-distribution implications of the findings seem to accord fairly well with the proposition that inner-oriented trade strategies and measures that increased incentives for using capital-intensive techniques probably contributed to a less equal income distribution than might otherwise have been observed. The very fact that HOS exportable industries tend to be relatively intensive in the use of unskilled industrial labor suggests that additional employment in those industries would increase the rate at which the urban sector could absorb new entrants to the labor force. To be sure, insofar as removal of labor market legislation might reduce the real incomes of industrial workers, there would tend to be a partial offset; however, in most of the countries covered in the project, employed industrial workers were a small elite receiving relatively high earnings at the expense of fewer employment opportunities in the industrial sector and lower earnings for those unable to find employment within it. Paul Schultz's finding, that effective protection tended to increase employers' earnings proportionately three times as much as employees' earnings, even within industries and after adjustment for age and other variables, is also significant in suggesting the compatibility of real income, employment, and income-distribution goals.[1]

Among the many findings of the project, another deserves special note by way of conclusion. That is the degree to which manufactured exports supplied in response to regional arrangements turned out to be relatively high-cost and apparently uneconomic. On one hand the evidence certainly suggests that the potential gains from regional trade in manufactures, if undertaken behind a common wall of protection, are probably relatively small, if not negative. On the other hand it suggests that the large potential gains in real income, growth rates, employment, and income distribution are attainable largely through an outer-oriented trade strategy that would result in increased exports of manufactures to developed countries under fairly uniform incentives.

The first point once again underscores the important conclusion that exports emanating from the ad hoc, specific, and widely varying incentives created under an import substitution regime do not usually provide the resource allocation gains that can result from uniform, across-the-board incentives. While there is undoubtedly scope for gainful intra-LDC trade,[2] it seems clear that the type of trade in manufactures that has been encouraged under regional trading arrangements has generally been more the outcome of the import substitution type of incentives than of the incentives that accompany a genuine outer-oriented trade strategy.

The second consideration, that the major gains from an outer-oriented trade strategy are likely to arise in trade with developed countries because of their very different factor endowments, points to the crucial importance of access to developed country markets in permitting developing countries to achieve maximum gains from appropriate trade policies and well-functioning domestic factor markets. While the inefficiencies of some import substitution regimes are so pronounced that there would in any event be gains by alteration of trade strategies, the magnitude of those potential gains is greater when access to markets is unrestricted and those markets are growing rapidly. This is not the place to assess the prospects for protectionist pressures in the developed countries, except to note that exporting LDCs have been able to increase their shares of world markets despite protectionist pressures and that, in the past, those who have cautioned against an outer-oriented trade strategy because of some form of export pessimism have been proved wrong.

What is clear is that maintaining access to markets of the developed countries is one of the major contributions developed countries can make to the growth prospects of developing countries, especially middle-income developing countries. While appropriate policies in LDCs, with respect to domestic markets, the trade regime, education, and much more, are a necessary condition for increasing prospective rates of growth of real income and living standards, those same policies clearly have a larger potential payoff in a liberal international economy.